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The 1985-1986 U.S. Regional Outlook

Growing Signs of Uncertainty— Yet The Mood Is Generally Positive

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ECONOMIC AND POLICY ANALYSIS PROGRAM

The Conference Board's Seventh Annual Regional Forum met in February 1985, gathering eight experts from around the country. The Forum's deliberations are summarized in this report.

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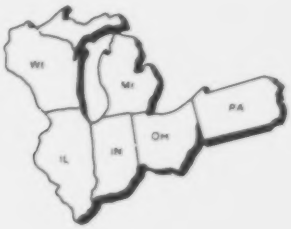
HIGHLIGHTS

The New England economy is in a quite favorable situation. Unemployment is low, employment is increasing at a respectable pace, and per capita income is high. Defense-related manufacturing, important in the region, promises to remain a steady source of job growth. Prospects for capital goods and exports, also regionally important, are clouded by the strength of the dollar. Also, the region may experience some labor shortages. However, New England should fare well in the next several years.

NEW ENGLAND

INDUSTRIAL HEARTLAND

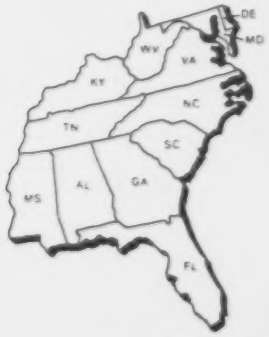


The economic recovery that had begun to be felt in the Industrial Heartland faltered in the second half of 1984. This resulted in part from the national slowdown and in part from the region's orientation toward durable goods of the traditional type rather than toward the booming "high-tech" sector. Also, the strong dollar has dampened export markets for Heartland goods and boosted import competition. With significant structural problems remaining, a bright future for the Heartland seems many years away.

The 1984 recovery was robust in the Mid-Atlantic, with all major economic indicators recording the best rates of improvement in well over a decade. Much of the growth was due to the strong economy of the 17-county New York-New Jersey metropolitan area. The prognosis for 1985 is good. Although the strong dollar is hurting manufacturing, and a housing shortage and lagging infrastructure investment cause concern, economic growth is consolidating into a fundamentally strong base.

MID-ATLANTIC

SOUTHEAST



The economy of the Southeast continues to reflect the general trends of the national economy. Really fast growth has been confined to Florida and Georgia during the past two years and that pattern should continue. The economic picture for the other states is mixed. The middle south is experiencing the difficulties associated with older, declining industries, while Alabama, Mississippi and West Virginia continue to lag. Overall, the region's profile is becoming more like that of the nation and its prospects more similar to the national outlook.

These are troubled times for the nation's agricultural regions. Growing stocks of farm commodities, high real interest rates, sluggish farm export demand, and falling farm asset values are sapping the vitality of American agriculture. Farm income rebounded in 1984 but will be sharply lower in 1985. An improved farm economy is both a number of years in the future and importantly dependent upon improved national economic policies.

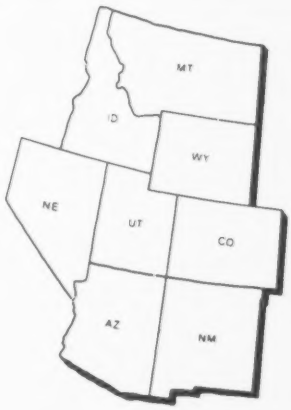
AMERICA'S BREADBASKET

SOUTHWEST

Assuming continued national economic growth, the Southwest economy will continue to expand. However, growth will not be as strong as it was during the energy boom. Many parts of the region are undergoing fundamental structural adjustments in energy and energy-related industries, and these adjustments probably represent some permanent losses to the region's economy. The bright spots are concentrated in the rapidly growing high-tech industries located in Texas' "Silicon Gulch."

There are divergent trends in the Mountain region. The diversified economies of the southern tier of states have done well despite the energy boom's demise, but the resource-based northern states remain depressed. The sources of strength for the southern states are widespread and their outlook is for continued growth at least at the national average pace. But slow growth is likely to continue to characterize the northern tier for some time.

MOUNTAIN STATES



PACIFIC

The economies of the Pacific region fared well in 1984, mirroring the national experience. California had very strong growth, led by aerospace and electronics. Although high-tech industries are becoming more important in Washington and Oregon, their timber industry remains depressed. The region should perform marginally better than the nation in the next few years, with high-tech industries a positive factor and timber, energy and agriculture negative ones.

Constant Change is a Fact of Economic Life

Lora S. Collins

The meeting of the 1985-1986 Regional Economic Forum was held at a time when the national economic news was ambiguous. In general, the Forum members expected sustained—although not particularly strong—economic growth through 1985, with a very subdued inflation rate. While the Forum participants were worried about developments beyond the near horizon, however, their concern did not extend to the spelling out of any specific bleak scenarios. In fact, the anxiety level among Forum participants was quite low. Their most clearly articulated worry was that the economy would suffer some setback in 1986, but many in the group foresaw at worst a "growth recession," i.e., simply a deceleration of the economic growth rate.

Because of the general absence of serious concern over the national economy's condition and prospects, the Forum meeting focused with special clarity on the particular characteristics of the country's regions. A pervasive theme of the meeting was that rapid adjustment and change are a continuing fact of the American economy. Areas that have traditionally—or at least in recent decades—been considered as ailing are in good shape while those that seemed to be without a care are having difficulties. New York City and State are running fiscal surpluses while Texas has a deficit. Significant structural changes are underway—for instance, in the energy industries in the Southwest and Mountain regions, mining in the Mountains, lumber in the Northwest, old-line manufacturing in the Southeast, and in agriculture everywhere. But significant structural change has been a constant factor in American life: It is a real strength of the economy that hardly anything remains always as it was.

New England

Katharine L. Bradbury*
Federal Reserve Bank of Boston

The unemployment rate in New England has hovered around 4½ percent since last Summer. The region has not seen rates this low since 1970. Meanwhile, the national rate fell gradually from about 7½ percent last Summer to 7.1 percent in November, and has risen slightly since then. Rates in both New England and the nation have fallen 3½ percentage points since the recession trough in November, 1982, but the U.S. rate is still about a percentage point *above* the level in January, 1980, while New England's rate is a percentage point *below* the pre-recession peak. Thus, according to unemployment measures, the New England economy is booming, having recovered entirely from the two recessions of the early 1980's while the nation still has some way to go.

Figures on regional employment growth also paint a picture of a booming region. Total nonagricultural employment grew 11 percent in New England in the recovery through January, and 8 percent in the nation. (See table). Growth in all the New England states exceeded the national average. In Massachusetts and New Hampshire, both manufacturing and nonmanufacturing employment grew at a double-digit pace between November, 1982 and January, 1985. Job growth in the other four New England states was concentrated in the nonmanufacturing sector, especially construction and trade.

New England's strong employment growth is surprising because New England did not suffer as great an employment decline in the recession as did the nation. Viewing the entire period from January, 1980 through November, 1982 as one long recession, the contrast is quite striking: U.S. total employment declined by 2.3 percent but New England's fell only 0.5 percent. Taking this longer view, New England's current employment performance is quite impressive: as the table shows, neither the nation nor the region has regained January, 1980 employment levels in manufacturing; New England was down 1.5 percent, the nation 5.1 percent as of January, 1985. But with strong growth in the nonmanufacturing sector, total employment in New England increased 10.4 in five years, while in the nation as a whole it grew 5.7 percent.

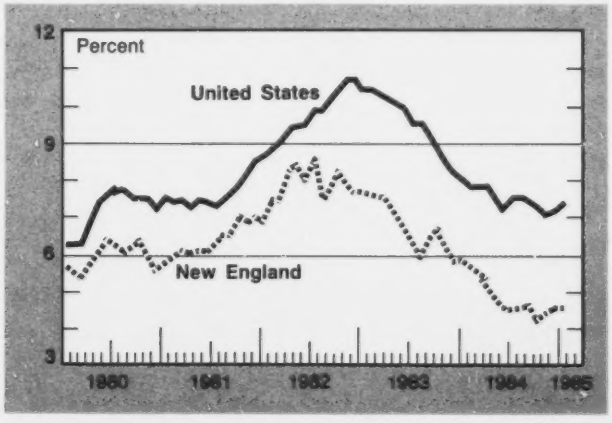
Taking an even longer view, personal income data also suggest that the New England economy is quite strong. In 1970, the average per capita income in the New England states was 109 percent of the U.S. average, roughly where it had been since at least the mid-1950's. It declined fairly steadily relative to the national average during the 1970's, hitting 103 percent in 1977, where it stayed through 1979. From 1980 to 1983, as recessions hit other regions quite hard, New England's relative position improved steadily. In 1983, per capita personal income in New England rose to 111 percent of the national average, the highest of any of the nine census regions.

Thus, on balance, New England's situation is quite favorable. Unemployment is low; employment has increased at a surprising pace; and personal income per capita is high. What can be said about the future? Assuming no big shocks in the national economy, New England's prospects depend most heavily on local labor-market conditions and three economic sectors important in the region—defense, exports and investment goods.

Defense promises to remain a steady source of employment strength in New England. In spite of the current budget debate, federal defense spending is likely to grow about 5 percent annually in real terms over the next few years, a faster pace than total GNP growth. New England particularly benefits from defense spending because it captures 11 to 12 percent of the nation's prime defense contracts, although it has only 6 percent of the nation's total employment.

The prospects for capital goods and exports are tied up with the strength of the U.S. dollar. Manufacturing in New England is more concentrated in industries responsive to business investment spending than is manufacturing nationwide. Based on surveys of capital spending plans, forecasters are expecting growth in equipment purchases to exceed total output growth rates over the next several years. This is good news for New England's durable goods manufacturers, but it would be better news if they and other domestic producers could be certain of capturing the lion's share of the spending increase. The problem is that imports have snagged over half the growth in capital equipment spending since the dollar began rising in 1981.

Chart 1:
Unemployment Rate—United States and New England



*The views expressed are those of the author and do not necessarily represent those of the Federal Reserve Board or the Federal Reserve Bank of Boston.

Table 1: Percent Changes in Nonfarm Wage and Salary Employment in Recessions and Recovery—United States and New England

	Total	*Manufacturing*	*Durable Goods*	*Nondurable Goods*	*Manufacturing*
Two recessions and recovery 1/80-1/85					
United States	5.7	–5.1	–6.2	–3.4	9.0
New England	10.4	–1.5	NA	NA	15.0
Recovery 11/82 - 1/85					
United States	8.3	9.8	13.5	4.6	7.9
New England	10.9	8.3	11.2	2.7	11.8
Connecticut	9.0	4.6	4.6	4.8	10.7
Maine	8.7	0.4	12.8	–7.1	11.7
Massachusetts	11.5	11.4	15.7	3.3	11.6
New Hampshire	18.5	17.4	24.2	5.2	19.0
Rhode Island	9.1	5.8	4.1	9.5	10.5
Vermont	9.1	3.4	3.8	2.2	10.8

The problem is the same with exports. New England producers have historically exported a higher fraction of their output than the national average. Now that the recovery is fairly well established worldwide, these export-oriented industries should be booming, but the strong dollar obviously puts U.S. producers at a disadvantage in world markets, just as it does in those domestic markets where foreigners compete. Most forecasters are predicting some decline in the dollar over the next few years, although no big plunge. This should somewhat improve the situation for New England capital goods producers in general, and for those that have historically focused on exports in particular.

One other cloud on the horizon is that New England's growth may be constrained by labor shortages. While shortages of professional and technical workers are not new to New England, much of the region is now experiencing shortages of lower-level office personnel and sales workers. Low unemployment rates are one indication; in addition, anecdotal evidence of shortages in specific locations and occupations appears regularly in news stories.

At this point, it is not clear how the region will adjust. Wages are rising—the average manufacturing production worker's wage rose 7½ percent over the last two years in the nation, while the New England average rose 10 percent, bringing wages in the region to 93 percent of the U.S. average (up from 87 percent as recently as the beginning of 1982). These higher wages are likely to encourage some combination of increased net in-migration to the region, greater intra-regional moves (or longer commutes toward the tightest labor-market areas), and increases in the labor-force participation rate. If these responses are not enough, there will also be a slowing of employment growth, as hiring difficulties discourage firms from moving into, or expanding in, New England.

In sum, New England should fare quite well over the next few years. Overall, employment in the region is likely to grow more slowly than in the nation, but moderate employment growth should not be particularly troublesome for a region with population growth at roughly half the national rate in recent years. Unemployment rates should stay well below average, and per capita incomes are likely to hold their strength. Labor shortages are a "problem" that many regions wish they were facing.

"The Industrial Heartland"

Wynn V. Bussmann
TRW

The economic recovery that had begun to be felt in the Industrial Heartland faltered in the last half of 1984. Part of the weakness is explained by the slowdown in the national economy and part is explained by other reasons.

Total manufacturing employment nationwide grew at an annual rate of 6 percent in the first half of 1984 but slowed to a 1.5 percent rate in the second half. Because of the disproportionately high concentration of manufacturing in the economy of the Heartland, the effects of the general economic slowdown were magnified in the region. The region's manufacturing employment, which grew at a 4-percent rate in the first six months of 1984, is estimated to have shrunk at about a 1-percent rate in the last six. Furthermore, employment in nonmanufacturing failed to take up the slack so that growth in total nonagricultural employment slowed from about a 2.5 percent rate in the first half of 1984 to a 1.5-percent rate in the second half.

In addition to being highly manufacturing oriented, the Heartland economy is heavily oriented toward the production of durable goods of the traditional type. Although investment in new plant and equipment has been extraordinarily strong in the general economic recovery, the bulk of this strength has been concentrated in high-technology equipment (see table) and much of this is manufactured in other regions of the country.

The $11.3 billion increase in expenditures for high-technology equipment from 1983 to 1984 was approached only by the $8.9 billion increase in transportation equipment. Indeed, the $16 billion increase in expenditures for high-technology equipment since 1982 almost equaled the $16.5 billion increase in the sum of the other three categories. Such figures light up the eyes of regional developers.

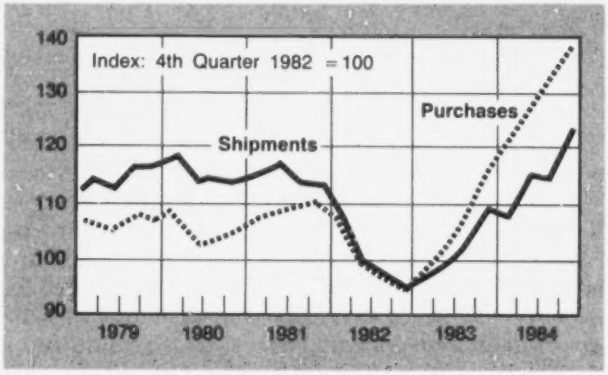
The Heartland's problems are secular as well as cyclical. In 1970, constant-dollar expenditures on high-technology equipment constituted 25.4 percent of the total of the four categories shown in the table. By 1984, that percentage had risen to 51.7 percent.

Table 2: Expenditures for Selected Types of Equipment (billions of 1972 dollars)

	High-technology	*Heavy Industrial*	*Trans-portation*	*Construction and Agriculture*
1978 ...	33.3	25.8	30.7	10.9
1979 ...	39.1	26.9	30.7	10.8
1980 ...	44.9	26.3	23.9	8.5
1981 ...	50.6	25.8	23.6	7.8
1982 ...	52.8	21.6	21.2	5.0
1983 ...	57.5	21.0	24.8	5.2
1984 ...	68.8	24.9	33.7	5.7

Chart 2:

U.S. Purchases and Manufacturers' Shipments of Capital Equipment



Furthermore, it appears that the constant-dollar expenditures on items like computers have been seriously understated in recent years. The reason for this understatement is that the Commerce Department has been assuming a constant price deflator for computers when, in fact, actual prices have been falling—in recent years (since the introduction of the chip) by between 20 and 30 percent per year. When the Commerce Department gets around to restating history next December with a more accurate estimate of price deflators, investment in high-technology equipment will be shown to be an even larger proportion of the total.

The strong dollar is another reason for the economic difficulties of the Heartland region, as manufactured goods have lost competitiveness on international markets. In addition, local manufacturers have to contend with cheaper imports making inroads into what used to be their private domains. Thus, not all of the expenditures shown in the table were for domestically produced equipment. Since the trough in the fourth quarter of 1982, U.S. purchases of capital equipment have risen almost 40 percent while shipments from U.S. producers of capital equipment have risen only about 25 percent. The difference, of course, has been made up by imports.

The prospects for the economic rejuvenation of the Industrial Heartland in the near term are not bright. If the dollar stays strong, no relief from imports is in sight and the prospects for exports will not improve. If Congress slashes

the budget deficit to bring down interest rates, and the dollar drops as a result, then the economy will probably be in a recession which, at least in the short run, will hit the Heartland especially hard.

Any improvement from a weaker dollar or from a switch to high-technology goods production will take time to be felt. Thus, while one can imagine a bright future for the region, that future seems at least many years away.

The Mid-Atlantic

Rosemary Scanlon
Port Authority of New York & New Jersey

The 1984 recovery was robust in both New York and New Jersey. All major economic indicators—employment, unemployment, personal income, retail sales, construction and the specialized business and office functions—recorded the best rates of improvement in well over a decade. What is more, the strong regional economy has led to a stabilization in population, in contrast to the declines registered during the 1970's, together with growth in the regional labor force. By year-end 1984, only a few key factors, such as the housing shortage and lagging infrastructure investment, gave cause for concern.

Table 3: Mid-Atlantic Economic Indicators

	New York	New Jersey	N.Y.-N.J. Metropolitan Region
Nonagricultural Employment			
Level in 1984 (thousands)	7,336	3,339	7,106
Percent change, 1983-1984	3.1	5.6	3.6
Manufacturing Employment			
Level in 1984 (thousands)	1,302	729	1,228
Percent change, 1983-1984	2.2	2.0	1.7
Unemployment Rate (%)			
1983	8.6	7.8	8.1
1984	7.2	6.2	7.0
Personal Income			
Percent change, 1983-1984	8.9	10.0	N.A.
Retail Sales			
Percent change, 1983-1984	11.5	10.3	11.3
Construction Activity[1]			
Level in 1984 ($ billions)	9.3	6.4	9.0
Percent change, 1983-1984	13.3	13.5	16.2
Air Passengers			
Level in 1984 (millions)	N.A.	N.A.	73.9
Percent change, 1983-1984	N.A.	N.A.	15.2

[1]Source: F.W. Dodge

Employment in the region rebounded sharply in 1984. The rise was a bit less in percentage terms than the national gain, but it came from a relatively high base that reflected the relatively mild regional impact of the 1981-1982 recession. In New York State, wage and salary employment in 1984 was up by 174,000, a gain of 2.4 percent, to a level of 7.46 million. In New Jersey, jobs increased by 116,000 or 3.4 percent, to an average of 3.26 million in 1984.

In both states, growth was led by the services, both personal and business, as well as trade, finance and construction. Manufacturing employment edged up from the recession, with jobs up 15,000, or 1.3 percent, in New York, and 22,000, or 3.1 percent, in New Jersey.

The strong job market and relatively fewer entrants to the labor force worked to push unemployment rates under the national average. In New Jersey, the rate fell to an average of 6.2 percent in 1984, down from 7.8 percent in 1983. In New York State, unemployment declined from an average of 8.6 percent in 1983 to 7.2 percent in 1984.

The construction industry was particularly strong. F.W. Dodge reports that the value of all construction awards reached $9.2. billion in New York in 1984, an increase of 13.3 percent over 1983—well above the national increase of 8.4 percent. New Jersey's construction industry was similarly buoyant, with contract awards reaching $6.4 billion, a 13.5 percent gain from 1983.

As a result of the strong job market, total personal income in each state increased by 9 percent in 1984 (based on data through the first nine months), and retail sales were strong, up almost 12 percent in New York and 11 percent in New Jersey.

Much of the region's economic strength was due to the strong economy of the 17-county New York-New Jersey metropolitan area, which saw a gain of 182,000 jobs, a rapid decline in unemployment rates (the region's unemployment fell to 6.1 percent by year-end 1984), and a strong business and finance sector that prompted an increase of 21 million square feet of new office space. Real estate leasing activity is strong, and the Manhattan central business district has one of the lowest office-vacancy rates in the nation. Tourist and travel indicators posted new highs for the year. The number of air passengers using the region's three major airports totaled 24 million, a gain of 29 percent in a two-year period.

The prognosis is good. Jobs are expected to increase, although less rapidly than the strong gains of 1984. Unemployment rates should come down quickly, including those in the central cities. Construction is expected to remain firm, with the only uncertainty in the housing sector; strong pent-up demand has yet to be matched by a sufficient increase in new housing, leading to shortages and rising prices for housing throughout the area. As unemployment falls, wage and salary gains will likely be large enough to lead to a brisk increase in personal income. However, the strong U.S. dollar is adversely affecting both states' manufacturing and export sectors, even though rising imports and depressed foreign-currency values have also contributed to lower inflation rates. In sum, 1985 should be a solid year, one in which economic growth is consolidating into a fundamentally strong income and fiscal base.

The Southeast

E. Blaine Liner
Liner Associates, Inc.

The economy of the Southeast continues to reflect the general trends of the national economy. For example, the region's unemployment dropped from 10 percent in 1983 to 8 percent for 1984; it can be expected to go even below that for 1985, if current trends continue. Although there was a general economic slowdown in the region during the last half of 1984, a turnaround during the closing months of the year has continued at a brisk pace in 1985.

With the exception of three problem states (Alabama, Mississippi and West Virginia), growth rates in income are higher than those of the nation. Really fast growth has been confined to Florida and Georgia during the past two years, and that pattern should continue well into the future. Florida and Georgia will again be national leaders in rates of increase in employment, income and retail sales, a repeat of the 1984 record-setting expansions in both states.

Florida accounts for one-third of the Southeast's income and, like last year, will be adding about 25,000 new residents per month during 1985; the growth from this one phenomenon—migration to Florida—accounts for much of the impressive data for this region. Georgia has many large national defense installations and related manufacturing plants; Atlanta has increasingly dominated other cities as the region's capital city; and automobile manufacturing is a major Georgia industry. All three factors weighed heavily in the 1984 increases and contribute greatly to the positive economic outlook for 1985 and beyond. While both states are very favorably situated in the defense industries, their tourism and recreation sectors were highly profitable in past years and are expected to be very important in the future.

The economic picture for the other states is mixed. The middle South is heavily dominated by older, basic industries such as textiles, apparel, tobacco and furniture. As long as this is the case, that area will continue to experience the difficulties associated with declining industries, especially competition from imports. Heavy capital spending for plant modernization in each of these industries during 1984 not only spurred the construction sector but will help take these industries to more internationally competitive levels of productivity. Employment in textiles, for instance, is now at the lowest point in two decades but output is up. The future of these industries now enters the phase where the only avenues left for improvement are likely to be political—import-export issues and the strength of the dollar overseas, regulatory issues, and the health questions and governmental actions related to tobacco and smoking.

Despite these structural considerations, the migration to the region is so strong as to mask most problems. Data indicating any downside trends often get swamped by the data reflecting the arrival of new residents, and the new construction, new services, and additional spending that comes with them. Therefore, income growth is expected to continue at least at the national rate and probably a bit higher. This has been the pattern in the recent past and there is little evidence to support any other conclusion. Capital spending in the region is up; personal income is up; and 1984 witnessed healthy increases in the nonmanufacturing employment that contributes to the diversification of the regional economy.

Financial markets are in great flux and can be expected to

be even more competitive as regional reciprocal interstate-banking laws become operational this coming July. Most financial institutions, large and small, have been hard at work on their options and plans for merging, selling and buying. They are looking forward to a rather invigorating shakeout period commencing this Summer. As a result, we can expect greater access to the large national and international capital markets, a change that can only help the traditionally capital-poor Southeast.

The building or expansion of plants by foreign firms continues to play an observable role in the southeastern economy. North Carolina, for example, had over 50 new or expanded plants in this category during 1984. Many of them are in sectors that add balance and diversification to the economic base, for instance, electronics, electrical machinery, and other high-technology areas.

The construction, finance, trade and service sectors, especially business services, continue to exhibit above-average growth, helping to pull much of the economy out of the 1982-1983 recession. A very slow but steady transition of the structure of the southeastern economy away from its historical profile in basic manufacturing and natural resource exploitation can be seen in the cyclical surges, which are nearly always associated with large growth in nonmanufacturing production.

Although it is difficult to conceive of an even lower level of agricultural employment, it should be expected. Now in its third decade of precipitous fall, agricultural employment will go even lower as tobacco farmers brace for a loss of price supports, markets, or both—adding an additional group of farmers to those already retrenching due to uneconomic production-unit sizes. This will, of course, be most strongly felt in the local economies along the "tobacco road."

In summary, the Southeast will continue to mirror the national economic performance to a great extent. Within this general pattern, Florida and Georgia will be the regional leaders, and Alabama, Mississippi and West Virginia will perform at the lower end. Continued evolution of the regional economy's structure toward nonmanufacturing will be in evidence. Historically, the southeastern economy was countercyclical because of its "colonial" characteristics. It is now beginning to perform more in step with the nation.

Federal Government decisions will have a major impact on the performance of the economy in terms of exports, defense expenditures, and agricultural policy. A major unknown will be the impact on the economy of state and local government expenditures for capital goods, construction and employment. Major cutbacks in federal funds as part of the deficit-reduction program, affecting programs such as general revenue sharing, would have a measurable regional impact on this large sector of the southeastern economy.

"America's Breadbasket"

Marvin Duncan*
Federal Reserve Bank of Kansas City

These are troubled times for the Breadbasket. While 1984 yielded sharply higher farm income, the year ahead promises to be one of renewed decline in farm income. Growing stocks of farm commodities, high real interest rates, sluggish farm export demand, and falling farm asset values are sapping the economic vitality of American agriculture and the spirit of its farmers. Although in part an inevitable result of a changed economic climate, these circumstances have resulted in serious financial stress for a growing proportion—albeit a minority—of America's farmers. An improved farm economy is both a number of years in the future and importantly dependent on improved national economic policies.

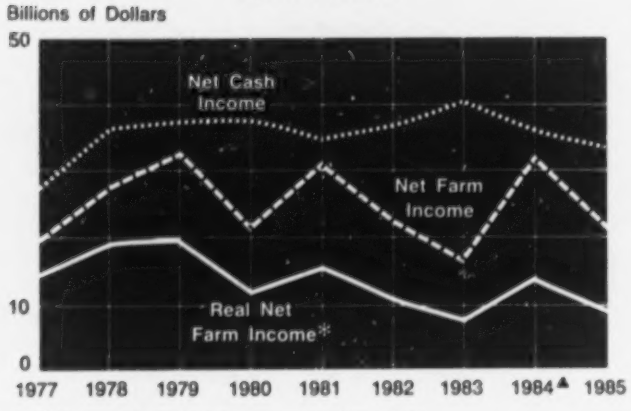
America's farmers were heartened by a near doubling of net farm income in 1984, to about $31 billion. Even in inflation adjusted 1972 dollars, this represented an income level nearly as high as that reached in 1981, the most recent previous year with relatively favorable farm income. The farm income improvement in 1984 was, however, dependent on large increases in farmer held stocks of crops and direct government payments of $7-10 billion.

The year ahead promises to be one in which net farm income tumbles sharply to the $21-22 billion range (Chart 3). In 1972 dollars, net farm income will be back to the $8-13 billion range that has characterized the decade of the 1980's. Some improvement in both crop and livestock receipts in 1985 will only about offset a forecasted sharp drop in government payments. Inventory change will not add to farm income and production expenses will increase. Net cash income—the difference between cash income and cash expenditures—will decline for the second consecutive year, posing increased problems for farmers in meeting obligations for production costs and debt service.

*The views expressed are those of the author and do not necessarily represent those of the Federal Reserve Board or the Federal Reserve Bank of Kansas City.

Chart 3:

Farm Income



*Measured in 1972 dollars ▲Estimated

Source: U.S. Department of Agriculture

The impact of reduced farm income in 1985 will not be shared uniformly across the sector. Livestock profits should improve compared to 1984 as a result of higher prices for meat animals and lower feed costs. Receipts of poultry and egg producers will decline while dairy product receipts will hold steady. Crop profits will likely decline as crop prices slide below year-earlier levels during most of 1985. Food and feed grain receipts may improve slightly on the basis of higher production, while oil seed crop receipts will decline because of sharp price reductions. Cotton receipts will decrease substantially due to lower cotton prices. Vegetable and fruit receipts may be down slightly, as well.

Farm export sales will decline in 1985 to about $35.5 billion, as lower commodity prices more than offset an increase in tonnage shipped. The gloomy export picture extends through 1985 and likely for at least a few more years. In 1986, both value and tonnage exported will decline from this year's levels, a discouraging note to U.S. farmers increasingly dependent on growth in export markets for farm prosperity.

Increasing evidence that U.S. rice, wheat, and cotton prices may sometimes be uncompetitive in world markets should cause government policymakers to more closely link government price supports to world market clearing prices. Despite farmer reluctance to accept that change in farm policy direction, a move toward market orientation appears necessary if the slide in farm export sales is to be reversed.

Although bad news for farmers, softer commodity prices are good for consumers. Food price increases in 1985 will moderate from 1984, running in the 2 to 5 percent range and below the general inflation rate expected for the year. Indeed, the farm value of food will likely register a decline in 1985. Consequently, U.S. consumers will spend only 14.6 percent of their disposable personal income for food in 1985, down from 16 percent in 1981 and arguably the world's best food bargain.

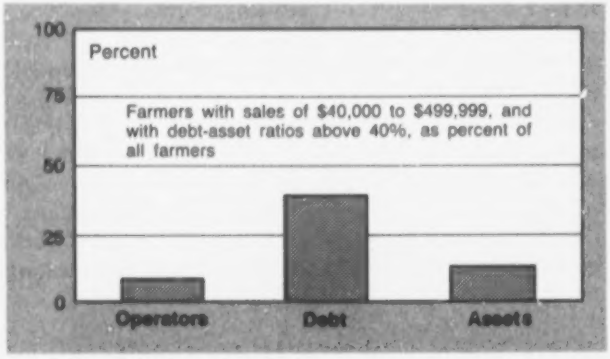
U.S. agriculture is in the midst of a difficult transition to a more austere economic climate as a result of the mature domestic market for food and fiber, relative price stability, financial market and transportation deregulation, and increased dependence on export markets in a world economy that currently exhibits only very slow growth. This transition has been made more difficult than necessary by the perverse impact of huge secular federal budget deficits on interest rates and thus on debt carrying costs and export competitiveness. As a consequence, farm asset values will continue to decline in 1985. Across much of the nation's agricultural heartland, farm land values have already fallen by 25 to 35 percent from their previous market peak in 1981. Further declines to about 50 percent of 1981 levels appear likely over the next one to three years.

Low farm product prices and declining asset values have surrounded heavily indebted farmers with a rapidly moving pincer action. Farmers with heavy indebtedness, relative to assets owned and farm cash flow, have been unable to service their outstanding debt satisfactorily. At the same time, declining asset values have diminished their creditworthiness. Some 210,000 farm operators with annual sales between $40,000 and $499,999—a classification that encompasses the core of the nation's commercial family farms—have debt-to-asset-ratios over 40 percent and likely are experiencing problems in servicing outstanding debt. This group, which represents about 9 percent of all the nation's farm operators, holds 14 percent of farm operator assets and 39 percent of farm operator debts (Chart 4). About 92,000 of these farm operators have debt-to-asset ratios exceeding 70 percent; for these, the outlook is grim. They most likely will be forced from business within the next two to three years. In the Tenth Federal Reserve District, farm failures and partial liquidations have been running about three times the rate bankers consider normal.

Farm financial stress and declines in farm asset values appear to be most acute in the nation's heartland where weather-induced production problems have undermined farm profitability in recent years. The problem is, nonetheless, national in character with only the northeast relatively unaffected. Farm problems have spilled over into agribusiness and

Chart 4:

Farm Debt and Assets

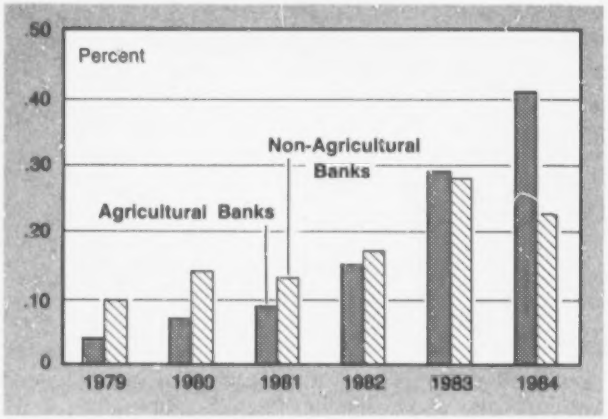


Source: Federal Reserve Board of Governors.

farm lending. In the Tenth Federal Reserve District, data indicate one-fifth of rural nonfarm businesses are experiencing severe financial stress. Sales by farm capital goods manufacturers are off sharply and the U.S. farm equipment industry is currently operating at about 40 to 50 percent of capacity. U.S. grain exporters are operating at only about 60 percent of capacity. Thus, profit margins for most rural and agribusinesses are very tight—and in many instances negative.

Agricultural lenders have experienced sharp increases in loan problems. Agricultural banks across the nation, in just the past two years, have changed from having substantially lower loan chargeoffs than nonagricultural banks of comparable size to having substantially higher loan chargeoffs (Chart 5). The trend toward higher loan chargeoffs appears to continue in 1985. While both the rural banking system and the Farm Credit System have sufficient resilience to ride out the troubled times in agriculture, failures of agricultural banks and Production Credit Associations increased sharply in 1984—but from extremely low levels. Moreover, heightened levels of failures appear likely in 1985.

Chart 5:
Net Charge-Offs as Percent of Total Loans
First half of year



Source: Federal Reserve Board of Governors.

In summary, U.S. farm income will be sharply lower in 1985. Crop producers will experience reduced profits while most livestock producers should have improved profits. Protracted income pressures and markedly higher inflation-adjusted interest rates have, in recent years, caused substantial reduction in farm asset values and resulted in serious financial pressures for heavily leveraged farmers and agribusinesses. Loan losses for agricultural lenders have escalated and are expected to climb higher in 1985. No prompt turnaround in farm sector profitability is in prospect, as the sector continues to be buffeted by slow world economic growth, increased competition in world markets, and the adverse effects of unprecedented peacetime federal budget deficits.

The Southwest

Bernard L. Weinstein
John Gray Institute

Nineteen eighty-four was a good year for the nation but an uneven year for the southwestern states of Texas, Oklahoma, Arkansas and Louisiana. As the national economy moved from rapid recovery to steady expansion, the region began to recover some of the job losses stemming from the 1982-1983 recession and the decline in oil prices. But most of the employment gains were recorded in Texas, with only moderate growth in the other three states.

During 1984, the unemployment rate dropped in Texas, Arkansas and Louisiana but rose slightly in Oklahoma. As the new year began, all of the states in the region, with the exception of Texas, were posting unemployment rates higher than the national average, and Louisiana was one of only five states in the nation with a double-digit unemployment rate.

The outlook for 1985 is cloudy at best. Because of the fairly rosy prognosis for the national economy, the region should continue to record gains in employment, income, construction and sales, although growth will not be as dynamic as during the energy boom of the late 1970's and early 1980's. Rising defense expenditures, especially for aerospace equipment, will provide a hefty boost to parts of Texas, especially the Dallas-Fort Worth area.

However, many parts of the Southwest are in the throes of a fundamental structural adjustment process, not dissimilar to that being experienced by the Midwest, that seriously constrains short-term growth prospects. During the 1970's, the Southwest rode to prosperity on the back of manufacturing, much of which was concentrated in industries either directly or indirectly dependent upon a healthy energy sector—industries such as petrochemicals and oil refining, fabricated metals and machinery manufacturing, and shipbuilding. Employment growth in these energy-related industries was rapid and, because the jobs were generally high-paying, a con-

Table 4: Unemployment Rate—United States and Southwest

	1984 Average	January 1984	January 1985
United States ...	7.5%	8.8%	8.0%
Texas	5.9	7.3	6.9
Oklahoma	7.0	7.9	8.2
Arkansas	8.9	10.5	8.6*
Louisiana	10.0	10.9	10.4*

*December 1984

siderable amount of purchasing power was injected into the regional economy. Moreover, the growth of energy-related manufacturing employment had a profound positive effect on other sectors, notably construction.

Since 1981, however, the Southwest has suffered substantial losses in the very same industries that were the engines of growth through the 1970's. Between 1981 and 1984, the region as a whole lost nearly 180,000 manufacturing jobs, over 10 percent of its industrial base. The largest relative loss, 18 percent, was recorded in Louisiana. Arkansas, by contrast, witnessed a slight gain, a reflection of its stronger dependence on light, labor-intensive manufacturing.

Table 5: Manufacturing Employment in the Southwest

	December 1981	December 1984	Percent Change
	(thousands)		
Southwest ..	1737.5	1559.7	-10.2%
Texas	1113.4	995.6	-10.6
Oklahoma ...	198.3	174.1	-12.2
Arkansas ...	203.2	207.4	2.1
Louisiana ...	222.6	182.6	-18.0

Most of the Southwest's manufacturing-employment retrenchment is a reflection of structural adjustments in the energy sector, and probably represents a permanent loss to the region's economy. The continued softening of oil prices since 1980 has depressed the drilling activity that would otherwise stimulate the region's fabricated-metal and machinery industries. At the same time, steadily declining domestic demand for gasoline and other refined products, as well as the emergence of more efficient refiners in Western Europe, the Caribbean, and North Africa, has encouraged the reduction of refining capacity. (Nearly 50 refineries in the Southwest have shut down or substantially reduced capacity since 1980.) The outlook for the region's chemical industry is also uncertain as foreign competitors are beginning to serve the market for basic feedstocks.

Further declines in oil prices may pose additional problems for the Southwest's economy. Although the experts were predicting "eighty-five in eighty-five" several years ago, the price of oil seems more likely to hit $25 a barrel than $85 a barrel this year. Substantial job losses were recorded during the 1982-1983 downturn in the "Oil Patch." The recovery, which began in late 1983, already shows signs of being aborted as oil prices resume their fall.

Fortunately, there are some bright spots on the horizon for the Southwest during 1985 and 1986. Most of the region's recent job growth has occurred along the Interstate 35 corridor, between Dallas-Fort Worth and San Antonio. This corridor, sometimes referred to as "Silicon Gulch," has become one of the nation's hot spots for high-tech industrial development. At 3.5 percent, Dallas-Fort Worth currently boasts the lowest unemployment rate among the nation's large metropolitan areas and will lead the nation in construction activity during 1985, and probably also in 1986. Austin is emerging as an important research and development center, and San Antonio has recently launched several programs to establish itself as a premier location for biotechnology research and commercial applications.

The Mountains

Lucy Black Creighton*
First Interstate Bank of Denver

The Mountain region continues to be marked by divergent trends. Arizona, Colorado, Nevada, New Mexico, and Utah, which comprise the southern tier of Mountain states, have recovered from the 1981-1982 recession at or above the national average, with substantial growth in service industries, high technology, and other state-of-the-art manufacturing. Although hard-hit by the demise of the western energy boom, the diversified economies of these states have more than offset the losses from energy.

In contrast, the more northern of the Mountain states—Idaho, Montana and Wyoming—remain heavily dependent on mining, forest products, and agriculture, and have been unable to shake off the effects of declining prices for oil and natural gas, wood, agricultural products, metals and coal.

The performance of the southern tier of states over the past two years is especially impressive in light of the braking effect of the downturn of oil prices. By November, 1984, U.S. nonagricultural wage and salary employment was 4.9 percent above its September, 1981 peak. For Arizona, the comparable gain was a whopping 18 percent, and even for Colorado, New Mexico and Utah—which were heavily involved in energy—the gain was in excess of 5 percent.

Other indicators confirm this sturdy performance. By late 1984, unemployment rates, which averaged well above 8 percent in 1982 and 1983, had fallen to less than 5 percent in Arizona, to 5.6 percent in Colorado, to 6 percent in Utah, and to close to 7 percent in New Mexico. Only Nevada showed a still-high 8 percent.

Led by Arizona, these same states achieved a gain of 1.5 percent in nonagricultural wage and salary employment in 1983, compared to a national increase of 0.6 percent. In 1984, the five states showed an estimated nonfarm employment growth of 4.6 percent, essentially equal to the national average of 4.5 percent.

Personal income also showed substantial gains, with average increases of 7.2 percent and 10.5 percent in 1983 and 1984, respectively, compared with nationwide increases of 6 percent in 1983 and just under 10 percent in 1984.

Lower mortgage rates made 1983 a banner year for housing in all five states, with new units up by 67 percent. While gains in 1984 were decidedly less spectacular, only Colorado and Nevada showed a decrease in new housing units compared with 1983.

The outlook for 1985 and 1986 is good. Assuming the national expansion does not falter, nonfarm employment in these states should maintain its advantage over the national average to achieve an average 4.3-percent growth rate for 1985 and something close to that in 1986. Following a 7-percent jump in employment last year, Arizona will again rank highest in growth in 1985, at a rate close to 6 percent.

Given the very rapid advance in housing over the past two years, housing in 1985 will generally be flat to down, with the overall variation closely tied to the trend of interest rates and to the progress of the national economy. Personal income should rise by 10 percent in 1985, and by an equal percentage in 1986.

Nonresidential construction shows continued gains in both Phoenix and Denver, the two largest urban areas in the Mountain region. In Phoenix, above-average employment growth supported a 50-percent increase in the value of nonresidential construction in 1984, with prospects for another 25-percent gain in 1985. In Denver, a 25-percent vacancy rate has dampened office building, but Denver's industrial and retail construction showed substantial gains in 1984, and the higher levels are expected to be maintained through 1985.

The sources of strength for these five diversified western states are widespread, and the longer-term outlook is for continued growth at or above the national average. Population growth rates are more than double the national rates and, for the 1980-1984 period, all these states were among the 10 fastest growing in the nation. Although they show strongly the effect of the national shift to an information and service-oriented economy, manufacturing is an important source of strength. Contrary to the national trend, which shows declining manufacturing employment, manufacturing jobs continue to rise in these states. In Phoenix, for example, manufacturing represents approximately 16 percent of metropolitan area wage and salary employment, and in 1984 and 1985 will show growth rates averaging 8 to 8.5 percent. The situation in Denver is similar, although the annual average growth rate of manufacturing jobs is a less-spectacular 5 percent. Most of this growth is in the high-technology manufacturing sector.

Along the northern tier of the Mountain region, Idaho, Montana and Wyoming have seen relatively few benefits from the 1983-1984 national economic expansion. Although prospects are looking up and unemployment rates have fallen substantially, nonfarm employment has yet to regain its pre-1980 high. The collapse of the energy boom, and especially of oil and gas exploration and development, was a severe loss. Furthermore, the important lumber and wood

*The author wishes to thank Jeffrey A. Haas, Regional Economist at First Interstate Bancorp in Los Angeles, for his assistance with this report.

Table 6: Mountain Region Economic Indicators

	1983	1984 (estimate)	1985 (forecast)	Percent Change 1983	1984	1985
Arizona, Colorado, Nevada, New Mexico, Utah,						
Nonfarm employment (thousands)	3,835	4,011	4,183	1.5	4.6	4.3
Housing permits	162,418	164,988	148,300	67.0	1.6	-10.1
Personal income ($ millions)	110,800	122,396	134,442	7.2	10.5	9.8
Population (thousands)	10,011	10,221	10,425	2.4	2.1	2.0
Idaho, Montana, Wyoming						
Nonfarm employment (thousands)	791	803	814	-1.2	1.5	1.4
Housing permits	14,095	12,253	11,600	47.0	-13.1	-5.3
Personal income ($ millions)	23,700	26,069	28,294	4.9	10	8.5
Population (thousands)	2,320	2,336	2,359	1.3	.7	2.9

products industry, hit first by the 1980-1982 downturn in housing, is now experiencing a prolonged decline in lumber prices. And agriculture in these states, as in the rest of the United States, is facing the difficulties of lower prices, reduced exports, and sharply declining land values.

Reduced rates of growth are likely to continue for some time in these heavily resource-dependent states. Long-standing industries are undergoing fundamental change, and relatively small and dispersed populations offer little opportunity for significant diversification. Declining oil prices will restrain the resurgence of oil and gas activity. Reduced rates of growth of electricity usage have cut the demand for coal. Hard-rock mining is facing competition from foreign sources of supply, as well as from downsizing and substitution of new and lighter materials in construction and in the production of automobiles and heavy equipment in general.

While the outlook for these three states is not very encouraging from a purely growth perspective, there is a brighter side. Employment growth was positive in 1984, unemployment rates are at or below the national average, and new housing construction has been substantial. Personal income also has shown steady growth, although per capita incomes in recent years have declined as a percent of the national average. The 1985-1986 outlook is for further improvement. Employment growth should average 1 to 2 percent both this year and next, with personal income gains at the 8.5-percent mark. Idaho, in particular, had a good 1984, which bodes well for further gains in 1985 and 1986.

The Pacific

Thomas D. Thomson
Crocker National Bank

The economies of the Pacific Region—Alaska, California, Hawaii, Oregon and Washington—fared well in 1984, mirroring the experience of the nation as a whole.

California, representing three-quarters of the entire region's population and employment, posted very strong economic gains in 1984. An additional 420,000 people were employed in the state in 1984, the greatest increase since 1978. The state's strongest growth industries continue to be the high-tech-related industries of aerospace and electronics. The aerospace industry—defined as firms producing commercial and military aircraft, guided missiles, and space vehicles—has grown at an annual rate of 13 percent in the last quarter, and currently employs about 215,000 people, or roughly 11 percent of the state's manufacturing work force. The future of this industry is expected to continue to be bright, with steady gains due to a continuing rise in defense spending, the success of the space shuttle, and additional capital outlays by the private sector for satellites. Contrary to some news stories, employment in the state's electronics industries rose in 1984. Preliminary figures indicate that employment in electronics grew 6.5 percent in 1984. Two factors will likely slow this rapid advance in the next few years, but growth will nonetheless remain positive: First, the industry is starting to go through a shakeout as the many firms that rapidly entered in the last several years compete for a limited commercial and personal computer market; second, and in the more immediate term, an inventory imbalance in semiconductor chips needs to be worked out.

As is the case in California, high-tech industry is becoming increasingly significant to the local economies in Washington and Oregon. The solid growth in nonfarm employment of roughly 3.5 percent over the last year in both these states is partly due to this.

In Washington, commercial aircraft production remains

Table 7: Pacific Region Economic Indicators

	United States	*Pacific*	*Alaska*	*California*	*Hawaii*	*Oregon*	*Washington*
Population (millions)							
1982	232.3	33.1	0.4	24.7	1.0	2.7	4.3
1983	234.5	33.6	0.5	25.2	1.0	2.7	4.3
1984	236.6	34.2	0.5	25.6	1.0	2.7	4.4
Nonfarm Employment (millions)							
1982	89.6	13.0	0.2	9.8	0.4	1.0	1.6
1983	90.1	13.2	0.2	10.0	0.4	1.0	1.6
1984	94.1	13.9	0.2	10.6	0.4	1.0	1.6
Unemployment Rate (%)							
1982	9.7	10.1	10.0	9.9	6.7	11.6	12.1
1983	9.6	9.7	10.5	9.7	6.4	10.9	11.2
1984	7.5	8.6	10.6	7.8	5.8	9.4	9.6
Personal Income ($ billions)							
1982	2584.6	407.7	7.5	311.6	11.6	27.1	50.0
1983	2744.2	435.3	8.2	333.7	12.4	28.6	52.4
1984	3012.0	481.5	9.1	371.1	13.3	31.2	56.8
Housing Permits (thousand units)							
1982	1351.0	122.4	8.0	84.8	5.7	7.1	17.0
1983	1602.0	223.7	11.2	171.9	4.8	8.6	27.2
1984	1647.0	268.4	6.5	218.0	5.4	8.0	30.5
Farm Receipts ($ billions)							
1982	144.8	19.7	0.02	14.4	0.5	1.8	3.0
1983	138.7	18.8	0.02	13.5	0.5	1.7	3.1
1984	141.4	19.8	0.19	14.3	0.5	1.8	3.0

an important force in the economy through direct and indirect employment. The outlook for this industry is bright as pressures mount for carriers to restock their fleets. The current lack of used aircraft will enhance sales of new equipment by carriers that must meet federal noise guidelines and growing demand for their services.

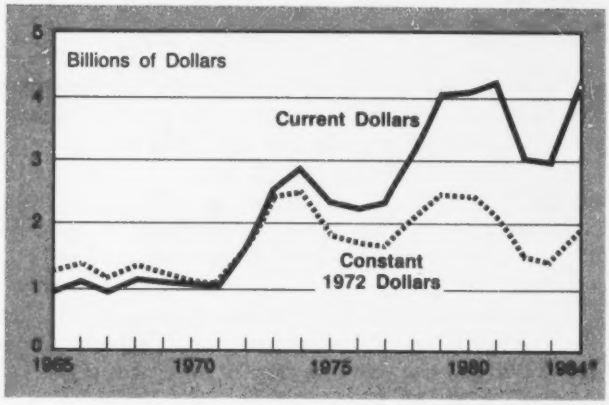
In Oregon, major efforts to lure new businesses into the state, especially high-tech-oriented ones, have been successful. Several Japanese firms have recently announced their decisions to locate in Oregon. The removal of the unitary tax law has been very important in this effort, in both effect and intention. Other factors include inexpensive property and the availability of skilled and relatively inexpensive labor. In addition, some analysts cite the very restrictive zoning laws in the state as a favorable factor in attracting companies to the region. This is because land uses have been carefully defined in the state with much of the land, in effect, preapproved for industrial building—minimizing the amount of red tape involved with development.

On a less positive note is the timber industry, a major business in northern California, Oregon and Washington. There is a current oversupply of lumber, which is due to a surge of imports from Canada, Brazil and Venezuela, the strong U.S. dollar, and less demand for wood in home construction. As a consequence, mills have shut down and timberland values have plummeted. Falling interest rates and last year's surging residential building have done little to help this situation. In the near term, the industry may receive some temporary help from the Timber Contract Relief Bill, which releases timber companies in the Northwest from federal timber-cutting contracts signed prior to the sharp drop in timber prices four years ago. However, the long-term outlook is not good.

Because of distress in the timber industry, growth in Oregon and Washington has been unevenly spread between the urban and rural areas. The urban areas are receiving the benefits of new high-tech-oriented industries while many of the rural areas, dependent on timber, have experienced little recovery. In addition, the primary metals and shipbuilding industries in Washington have been severely hurt by rising production of metals in third-world countries and a fairly dormant domestic shipping industry, respectively. The strong dollar has exacerbated these problems.

Tourism, an important business in all five states of the Pacific Region, has been disappointing except in Hawaii and Alaska. The disappointing flow of tourists to California, Oregon and Washington is partially due to the strong U.S. dollar, which has made traveling abroad particularly attractive to Americans while it has kept foreigners from coming into the United States. Falling air fares have also made travel to distant places more affordable to many Americans, adversely affecting domestic travel. In California, two major tourist events—the Summer Olympics in Los Angeles and the Democratic National Convention in San Francisco—were both disappointing in attracting record numbers of visitors. Adverse publicity prior to the events, and warnings of oppressive crowds, turned many people away from these events. In Hawaii where tourism is the number-one industry, the visitor industry has been exceptionally strong. This, in turn, has rippled through the entire economy, leading to an unemployment rate in 1984 of only 5.8 percent.

Chart 6:
California Net Farm Income



e = estimate

Agriculture is another very important industry in the region that has been experiencing difficult times. Although conditions vary among crops, it is fair to say that many farmers are currently grappling with product prices that have not kept up with production costs, low land values, and heavy debt burdens. In addition, the high value of the dollar has placed domestic farmers at a competitive disadvantage both abroad and at home.

Particularly hard hit by these problems have been California's specialty crops, most notably grapes. In addition to these adversities, however, the grape industry has had a problem of excess supplies, due in large part to an inherent three-to-five-year lag between planting and initial production. In the late 1970's, industry analysts expected consumption to continue to grow, following the impressive gains in table-wine and raisin-grape consumption during the 1970's. Consequently, plantings flourished. However, market conditions changed and the expected increase in demand for grapes did not materialize. Hence, the overzealous plantings of the early 1980's, which will soon become productive vineyards, will likely increase the current surplus even further.

The situation is not as dismal for many of the state's nonspecialty crops. Farmers of these crops have been better able to withstand these pressures due to their efficiency relative to domestic and foreign competitors. For this same reason, California farmers will likely be less hurt by the almost certain changes in federal farm policies, which will greatly alter the level of support that farmers have become accustomed to.

In Alaska, economic growth will be positive in the near term, although at a pace much less robust than in the last few years. Construction is expected to remain weak, with moderate growth in the service sectors. Government spending

will continue to play a less vital role in leading the economy, with private spending picking up the slack. The economic outlook in the longer term is cloudy, due to the state's dependence on the oil industry and the current uncertainty associated with oil prices.

Finally, all of the economies of the Pacific region will benefit from the growing ties of the United States to the Pacific Asian economies, most notably Japan, Korea, Taiwan, the People's Republic of China, Hong Kong, and Singapore. Trade continues to grow, directly benefiting the transportation industries and ports of Seattle, Portland, San Francisco, Los Angeles and Long Beach, and indirectly benefiting myriad other trade and service industries. The potential for strengthening these relationships is quite good.

In sum, the economies of the Pacific region are expected to perform marginally better than the nation as a whole in the next few years, although the region's performance margin will narrow. Aerospace and electronics will continue to be strong influences, while timber, agriculture and oil will exert negative pressures. Tourism will remain strong in Hawaii and Alaska, two states which have been able to overcome the strong dollar's negative influence on domestic travel, while tourism in California, Washington and Oregon will remain weak.